Docket No. 21,865

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

RSON MEADOWS, INCORPORATED,

Appellant,

vs.

TEL MAURICE CORPORATION,
al,

Appellees.

From

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

Bruce R. Thompson, Judge

APPELLANT'S BRIEF

Richard C. Minor
Attorney for Appellant
140 North Virginia St.
Reno, Nevada 89501

Docket No. 21,865

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

In re the Petition for a Chapter X
Reorganization of Carson Meadows,
Incorporated, Debtor.

From

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEVADA

Bruce R. Thompson, Judge

PETITION FOR REVIEW

Richard C. Minor
Attorney for Debtor-Appellant
140 North Virginia Street
Reno, Nevada 89501

ADDENDUM

JURISDICTIONAL STATEMENT

In accordance with Rule 18. 2 (b), the following statement is submitted setting forth the jurisdiction of the United States Court of Appeals for the Ninth Circuit to review and pass upon the merits of the order in question.

This matter originated with the filing of a petition in the United States District Court for the District of Nevada for voluntary corporate reorganization under Chaper X of the Bankruptcy Act of the United States of America.

Title 11, U. S. C., Sec. 1 (10) "Courts of Bankruptcy" shall include the United States District Courts.

Title 11, U. S. C., Sec. 1 (3) "Appellate Courts" shall include the United States Courts of Appeals and the Supreme Court of the United States.

Title 11, U. S. C., Sec. 2 (9) gives courts of bankruptcy the power to confirm or reject arrangements or plans proposed under the Act.

Title 11, U. S. C., Sec. 47 (a) says the United States Courts of Appeals . . . are hereby invested with appellate jurisdiction from the several courts of bankruptcy in their respective jurisdictions in proceedings in bankruptcy. . .

Title 11, U. S. C., Sec. 47 (b) Such appellate jurisdiction shall be exercised by appeal in the form and manner of an appeal.

In the Bankruptcy Act, Chapter X (11 U. S. C., Sections 501 to 676) provides for corporate reorganizations, and this was the procedure under which the debtor-appellant instituted the proceedings herein.

INDEX

STATEMENT OF FACTS

Debtor-appellant filed a petition for organization under Chapter X of the Bankptcy Code of the United State of America the District Court for the District of vada.

The District Judge appointed a Specl Master to hold a hearing and take tesmony concerning the debtor's petition, id hearing being held on December 1, 1966 Reno, Nevada.

The Special Master then made his reort to the District Judge recommending smissal of the debtor's petition. Obctions to the Report of the Special ster were filed. The District Judge en made an order dismissing the petition. btor-appellant then lodged this appeal.

SUMMARY OF ARGUMENT

The decision of the District Court ould be reversed because:

Proposition No. I

The Report of the Special Master is tally defective in that it fails to conin a finding of fact as to the good ith filing of the petition.

Proposition No. II

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ebtor's petition. Objections to the Report of the
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SUMMARY OF ARGUMENT

The decision of the District Court should
e reversed because:

ROPOSITION NO. I

The Report of the Special Master is fatally
efective in that it fails to contain a finding of fact
s to the good faith filing of the petition.

ROPOSITION NO. II

The Report of the Special Master is fatally
efective in that the conclusions stated therein are
ot supported by the law.

ROPOSITION NO. III

The District Judge erred in ordering the pe-
tion dismissed.

A. The findings are not supported by the
aw.

B. The reasoning in support of the order f dismissal is contrary to the intent of the Act.

ROPOSITION NO. IV

The Special Master misinterpreted the evi- ence concerning Finding of Fact Number 6.

ROPOSITION NO. V

The Special Master misinterpreted the vidence concerning Finding of Fact Number 7.

ARGUMENT

AY IT PLEASE THE COURT:

Proposition I

THE REPORT OF THE SPECIAL MASTER IS FATALLY DEFECTIVE IN THAT IT FAILS TO CONTAIN A FINDING OF FACT AS TO THE GOOD FAITH FILING OF THE PETITION.

The basic question to be answered here is hether or not the Report of the Special Master erein is fatally defective because of the failure of e Special Master to make a Finding of Fact as to hether the appellant's petition for reorganization nder Chapter X was filed by the debtor (appellant) good faith.

Appellant relies heavily upon Section 541, tle 11, United States Code, which provides:

"Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith, or dismissing it if not so satisfied."

In the instant case, the District Judge re-
red the petition of the debtor (appellant) to a
ecial Master, so that a hearing could be had and
eport made to the District Judge on the Findings
Fact of the Special Master. The hearing before
e Special Master occurred on December 1, 1966,
d a copy of the transcript is contained in the
cord on this appeal.

Subsequently, a Report of the Special
aster was filed on March 2, 1967, a copy of
ich is also contained in the record on this ap-
al. On page one (1) of this report, lines 20-24,
e Special Master indicates that he has a duty to
termine if good faith did in fact exist in the filing
this petition, as he was required to do under 11
S. C., Sec. 541, supra. In fact, the report
dings contained on pages 2 and 3 are silent as to
e question of good faith. No finding of fact was
de by the Special Master as to whether or not
od faith did exist, thereby rendering the report
complete and defecitive. Is this a fatal defect?

The District Judge, in his order of dismis-
l of the petition, states the purposes in referring
e matter to a Special Master for a hearing is to see
the tests of good faith exist when compared to
ction 546 (Order Dismissing Petition, page 2,
es 29-32), and if it can reasonably be expected
at a plan of reorganization can be effected (page
lines 1-2). The District Judge then states in
es 14-16 of page 3 that the Report of the Special
aster and the accompanying evidence fail to show
od faith on the petitioner's (debtor-appellant's)
rt. This is the fatal error upon which the appel-
nt herein contends was made. The Judge claims
titions are referred to masters to determine if good
th exists and if a plan can be put into effect.
e Master says in his report that he is bound by
w to determine if good faith does exist. The Mas-
then fails to make a finding, and in fact did not
ecifically determine at the December 1, 1966,
aring if 11 U. S. C., Sec. 546 (1-4) existed or

ot; then the Judge, armed with no evidence but any good intentions, dismisses the petition as not aving been filed in good faith "based upon the ndings of the Master and the other accompanying vidence". This clearly is contrary to the law and error, and this proceeding should be remanded to e District Court to have the Report of the Special aster supplemented so far as a finding of fact oncerning good faith, thereby making the report omplete and adequate as required by law.

Proposition II

THE REPORT OF THE SPECIAL MASTER IS FATALLY DEFECTIVE IN THAT THE CONCLUSIONS STATED THEREIN ARE NOT SUPPORTED BY THE LAW.

The question herein presented is whether not the Report of the Special Master, on file erein, is defective for the failure of the Findings Fact stated therein to be supported by the law.

The reorganization proceeding under Chapr X is one in which the petitioner seeks relief by eans of rehabilitation. Broadly speaking, a plan nothing more than a scheme or method for the nancial readjustment of the debtor corporation. nlike a petition under Chapters I through VII ealing with ordinary bankruptcy, a Chapter X petion does not seek the adjudication of the debtor a bankrupt. Nor may his petition at the outset ntemplate the liquidation and subsequent distrition of the debtor's estate. The aim or reorganition is to preserve, if possible, the going conrn values of the debtor's business, to scale down e claims of creditors and others, to provide for e development of a plan by the terms of which the btor, its creditors and stockholders, will receive ir and equitable treatment, and to enable the debr to go forward on a sound financial footing. If is proves impossible of accomplishment, then the organization proceeding may be terminated, and,

der certain circumstances, an adjudicated entered
d bankruptcy proceeded with. All this does not
ean, however, that a plan of reorganization may
t properly provide for ultimate liquidation as the
ly fair, equitable and feasible method of reor-
nizing the debtor. But it must be emphasized
at Congress did not intend that a Chapter X case
turned into a liquidation proceeding at the very
ginning, and a petition disclosing such a situa-
n must be dismissed as not filed in "good faith".
llier on Bankruptcy, Vol. 6, pages 763-765, Sec.
03, and cases cited thereunder.

In the instant case we submit that the
btor has made a showing that the appraised value
its real estate exceeds the obligations. In many
urts it is the practice of the court to approve the
tition summarily, even without hearings, in order
enable the debtor to have a reasonable chance of
abilitation. In fact the Statute (Secs. 140, 137
d 144) contemplates that the creditors may attack
e good faith in the filing of the petition at hear-
gs which follow the approval of the petition.
rsuant to Section 141 of the Act, the judge need
ly be "satisfied" that the petition has met the
isdictional requirements and was filed in good
th in order to approve it ex parte.

In the case of York v. Florida Southern
rp., 310 F. 2d. 109, it was held that a determin-
on that the corporation's property was worth
bstantially more than the mortgages was not
early erroneous under the evidence, and in view
this determination a holding that a voluntary pe-
ion for corporate reorganization was filed in good
th was not clearly erroneous and the petition
uld not be dismissed even though it appeared
tremely unlikely, in light of the position of the
rtage holders that they would not consent to any
organization plan, that plan could be effected.
is situation is almost fair square with the situa-
n in the instant case, but to make the instant
se even stronger, not all of the mortgagees have

licated an unwillingness to consent to a proper rganization plan. In York, it was further held t the fact, standing alone, that a class of se- ed creditors announces that it will not agree to corporate reorganization plan does not make it possible for a reorganization petition to be filed good faith under the Bankruptcy Act.

In Fidelity Assurance Assoc. v. Sims, 318 3, 87 L. Ed. 1032, it is indicated that there is no uirement under the Act for an immediate plan and t the debtor should have a reasonable time to rk out and present a plan. Then, if no plan can approved, an orderly liquidation can be had under Chapter X proceeding which would be for the nefit, not only of the creditors, but of the cor- ation and the stockholders, and it is further in- cated that no dismissal is necessary.

Based on the testimony before the Special ster (Transcript, page 20, line 17 through page line 1) the debtor has indicated a willingness to uidate such of the assets as are necessary to pay all creditors including the mortgage holders with hope of being able to continue in business after creditors have been satisfied.

In a straight bankruptcy proceeding as dis- guished from one in reorganization, a secured editor holding a mortgage and/or assignment of nts may take certain steps to sequester the rents. e courts take into consideration such factors as the nature of the mortgage transaction under the plicable state law; (2) the terms of the mortgage elf; (3) the acts of the parties thereunder; and whether equitable considerations applied by the deral Bankruptcy Court may alter the result. Gen- lly, the mortgagee must take affirmative steps to tain the rent either before or after bankruptcy. Collier on Bankruptcy, 14th Ed., Sec. 70.16(7), ge 1044.

In a reorganization proceeding where the come of a debtor may be vital to a successful

organization, the secured creditor claims must be ewed from a different perspective; he may be af- cted to the extent that the nature of his security an be converted to an equitable equivalent as op- osed to a straight liquidation where he is entitled look to his security as such. Consequently, the eatment of rent and profits in a reorganization pro- eeding may be different than in a straight bank- ptcy.

Generally, rents, profits or income accru- g from the debtor's property may be dealt with on e same basis as the property itself. 6 Collier, th Ed., Sec. 14.03(1), p. 5015. The reorganiza- on court may demand possession from a prior ceiver, trustee, agent, mortgagee or indenture ustee in possession and at the same time secure e rents and profits or income which have already ccrued and have been collected and held. A rtiori, the court may refuse to sequester or turn ver to a secured creditor rents and profits from the ecurity where the creditor is not in possession at e time the reorganization or superceded bank- ptcy began.

> "The court's power is consanant with the purposes of a reorganiza- tion proceeding, as stated in the text at the beginning of this dis- cussion* and is not unconstitutional. The secured creditor must yield to the exigencies of reorganization. But here also the exercise of the court's power is discretionary." 6 Collier on Bankruptcy, 14th Ed., Sec. 14.03, p. 5016.

Moreover, as has been stated many times, e reorganization proceedings seek to maintain the atus quo of the debtor corporation pending a reas- nable opportunity to rehabilitate and overhaul the ebtor's financial structure, and to this end secured s well as unsecured claimants may not only be

strained, but their claims may be dealt with and fected by the reorganization plan. 6 Collier, th Ed., Sec. 14.03 (1), p. 5008.

In this connection, a preliminary inquiry ould be made as to the existence of a valid as- gnment as security; there may only be an equit- le assignment; the mortgagor may be an agent to llect for the mortgagee; there may be a contract pay an indebtedness out of a fund or proceeds of rtain assets; or there may be a mere arrangement pay a debt already owing. In re Clarke Realty ., 234 Fed. 576 (C.A. 9, 1916); In re Realty sociates Securities Corp., 98 F. 2d. 722 (C.A. 1938); State Control Savings Bank v. Hemoy, 77 2d. 458 (C.A. 8, 1935).

Where rents and profits are ordered turned er, they do not constitute general assets thereby stributable to junior creditors and stockholders in pairment of the secured creditor's prior rights, t they may at least be used for the current oper- ing expenses of the debtor's business. 6 Collier th Ed. Sec. 14.03(1), p. 5017.

In In re Franklin Garden Apartments, Inc., 4 F. 2d. 451 (C.A. 2, 1941), a voluntary Chapter petition was approved and a trustee appointed. e debtor was engaged in the business of owning d operating real property and improvements ereon. One such property was a 123 unit apart- nt building subject to a morgage and assignment rent in the event of default. Also, the debtor ecuted a separate instrument assigning to the rtgagee the rents then due and thereafter to be- me due; also, the debtor appointed the mortgagee s agent to collect the rents; the mortgagee went to possession, collected the rents and paid var- us operating expenses.

Subsequently, the Chapter X was filed and e trustee sought possession of the premises and e use of the rents to complete the building by

stalling a water sprinkler. The court decreed that e trustee gain possession and the right to collect . rents subsequent to the filing of the Chapter X tition and enjoined the mortgagee from interfering erewith, and required an accounting of rents col- cted since the filing; also it authorized the pro- rement of a sprinkler system, furniture and rnishings, etc., as necessary to complete the ilding. The order authorized payment from the ntals "all expenses of administration of this pro- eding and, after the foregoing payments, to turn er the net balance of all rents to the mortgagee".

The Court of Appeals held that Sections 6 and 257 of Chapter X fully warranted awarding ssession to the trustee.

As to the using of the rents to complete the ilding, the court found that to allow this at the esent time (the proceeding had just begun and the uity in the building might be "elusive") would be fair and an inadequate protection for the mortga- e's rights, especially since it is not certain that ere will be any plan approved and the mortgaged emises may not be sold pursuant to Sec. 236 or e Chapter X proceedings may not be dismissed.

As to the use of the rentals for expenses, ey may be applied toward "current operating ex- nses but should not be used to pay expenses of ministration".

> ". . . While such expenses may hereafter be paid from rentals or other sources by virtue of Sections 241, 246 or 259 of the Chandler Act, 11 U.S.C.A. Secs. 641, 647, 659, there seems no justification for al- lowing them at the present time, or indeed for allowing them at any time, out of the security belonging to the mortgagee except insofar as the mortgaged property has received

benefit through the proceeding (Randolph v. Scruggs, 190 U.S. 533, 23 S.Ct. 710, 47 L. Ed. 1165; In re Centralia Refining Co., D.C. Ill., 35 F. Supp. 599, 602), or the mortgagee's rights are fully secured.

"Since the decision in Continental Illinois Nat. Bank & Trust Co. v. Chicago, Rock Island & P. Ry. Co., 294 U.S. 643, 675, 55 S. Ct. 595, 79 L. Ed. 1110, we have no doubt of the power of the district court to take possession of the mortgaged premises, collect the rents and enjoin the mortgagee from interfering therewith. Clark Bros. Co. v. Portex Oil Co., 9 Cir., 113 F.2d. 45, 47. We cannot know what further may be done until the submission of a plan of reorganization or the failure to achieve one. It is possible that one may be proposed which will leave a sufficient equity to justify the application of rental receipts to expenses of the proceeding and to the completion of building and procurement of equipment. It may leave the mortgagee in a better position than at present and not meet with any objection." p. 454

In a supplemental memorandum, the court ɔted that the mortgagee no longer objected to the se of rents to complete the building and that a lan had been adopted which did not require use of ıe rents to pay administrative expenses.

In Central Hanover Bank & Trust Co. v. hiladelphia & Reading Coal & Iron Co., 99 F. 2d. 42 (C.A. 3, 1938), a 77B proceeding, a trustee

ıder a mortgage covering almost all of the debtor's roperty securing a bond issue sought to have the come sequestered and impounded to protect the ondholder's title to the income. The petition was enied and the mortgage trustee appealed.

The court noted the rehabilitative nature of reorganization wherein the status quo is maintained while the debtor continues its operation as a oing concern. "The sequestration of substantially l of the debtor's current income would undoubtedly o impede its operation as a going concern as to nder well nigh impossible its reorganization as ıch." (p. 645)

As to the status of the income in the hands the trustee, the situation is analogous to a bankptcy proceeding, where the right of the mortgage editor to the income "attaches only to the net inome remaining after payment of proper administrave expenses, operating expenses and taxes," as lowed by the bankruptcy court. The court thus firmed the lower court's denial of the petition to equester and impound the income from the propty.

In another appeal in the same case, In re iladelphia & Reading Coal & Iron Co., 117 F. 2d. 6 (C.A. 3, 1941), the mortgage trustee sought to equester and impound the dividends paid on cerin stock which the debtor owned and which had en pledged under the mortgage securing the btor's bonds. The court refused to do so on the sis of its prior decision. No constitutional ghts are violated.

> ". . . On the contrary the right of the mortgage trustee ultimately to receive the income of the mortgaged and pledged property, to the extent necessary to satisfy the claims of the bondholders, became fixed on February 26, 1937, the day the

> petition for reorganization was approved by the court, and was thereafter subject only to the payment of the proper expenses of the operation of the debtor's business and the administration of its estate and to the terms of the plan of reorganization when and if approved and confirmed by the court. The custody of the income in the interim is obviously a matter of remedy and not of right since it was in any event subject to necessary operating and administrative expenses." p. 978

The argument was made that the debtor doesn't need the income to continue operating. The court noted that the rule refusing sequestration is founded upon the necessities involved in the continuing operation of the debtor as a going concern and when the necessities cease to exist, the rule would cease to be applicable. The district court took the proper view in saying "It would of course be possible to modify the original order, if it were made to appear that this particular income was not needed by the debtor to carry on its business operations, but that has not been shown to be the fact and, from what this court knows of the debtor's situation, in all probability could not be." p. 979)

Consequently, a mortgagee under a mortgage containing a right to collect rents and/or an assignee of rents as security for a debt may be ordered to turn over the property and rents collected subsequent to the filing of a petition under Chapter or the date of a superceded bankruptcy petition; likewise, such a creditor will not be allowed to sequester and impound rents collected by a trustee where the trustee or debtor in possession remains in possession. The rent in the hands of the

eorganization trustee may be used to pay current perating expenses and perhaps even administrative xpenses. It may be paid out to the mortgagee dur- ng the pending reorganization if in the court's dis- retion it is determined that the income is not and ill not be needed for a successful reorganization. he rules relating to straight bankruptcy in regard to ent on encumbered property must be modified ac- ordingly in a Chapter X reorganization proceeding.

As to the Special Master's statement in inding of Fact No. 7 "that Debtor's cash-flow in- ome from rentals and other sources is insufficient o meet past incurred, as well as current obligations ith respect to its secured creditors", the debtor ubmits that the Special Master's conception of the urposes of a Chapter X proceeding is not in accord- nce with the law; and to follow the Master's line of inking to his recommendation that the proceedings e dismissed would not only be completely ignoring he purposes as set forth above of a Chapter X pro- eeding but would be flying in the face of the cases erein cited.

Proposition III

THE DISTRICT JUDGE ERRED IN ORDERING THE PETITION DIS- MISSED.

A. The findings are not supported by the law.

The District Judge, in his Order of Dismis- al, lines 14-16, page 3, summarily disregards the vidence which substantiates debtor's petition that his assets exceed his liabilities, and the evidence that one of the mortgagees did in fact indicate a willingness to withhold action against the debtor until the debtor has had an opportunity to rehabili- tate itself. The Judge seems displeased (lines 24- 2, page 3) that it was not adduced whether or not the debtor's (appellant's) income currently was

ufficient to defray his current expenses. It seems
iat none of the creditors care, and that the Special
Master was negligent in his duty if he failed to de-
ermine this important fact. The fact remains
iough that the District Judge, pursuant to 11 U. S.
., Sec. 141, need only be "satisfied" that the pe-
tion has met the jurisdictional requirements and
as filed in good faith by the debtor in order to
pprove it.

B. The reasoning in support of the Order
f Dismissal is contrary to the intent of the Act.

The main purpose of Chapter X proceedings
s to allow a debtor a period of time to pay his
reditors according to a proposed plan. It is to
enefit all, not to injure the parties concerned. In
ie instant situation, the debtor's assets are valued
: an amount greatly in excess of his liabilities,
ut to cause them to be sold at a forced sale would
reatly diminish the amount the debtor would re-
eive for them. All the debtor-appellant asks for
erein is a chance to regain a financial foothold so
e can pay his just obligations. This is what the
:t intended, but the Judge in his order has denied
ven giving the debtor a chance. He has not even
t the debtor propose a plan to be considered.
learly, this is not what the Act was initiated for,
id the debtor should be given the chance to pro-
)se a plan to be considered by the creditors.

Proposition IV

THE SPECIAL MASTER MISINTERPRETED THE EVIDENCE CONCERNING FINDING OF FACT NUMBER 6.

Appellant contends that Finding of Fact
umber 6 is based upon a misinterpretation of the
stimony taken before the Special Master on Dec-
iber 1, 1966. In this regard, it appears that very
nited testimony concerning the attempts of the
btor-appellant to obtain financing has been taken,

nd that a narrow interpretation has been placed pon such testimony. The testimony has apparently een interpreted and assumed to apply to the entire orporate structure, whereas, in reality, the testiony (Transcript, page 25, lines 15-22) specifially sets out that the various financial statements ade by debtor were so given specifically in conection with a certain project, not the entire corprate outlook.

Proposition V

THE SPECIAL MASTER MISINTERPRETED THE EVIDENCE CONCERNING FINDING OF FACT NUMBER 7.

Appellant contends that Finding of Fact umber 7 is based upon a misinterpretation of the stimony taken before the Special Master on Decnber 1, 1966. The conclusion by the Master is sed upon a mere statement of Mr. Goldbeck, nich is merely a possible suggested alternative. o actual definite plan has been formulated and bmitted to the court or the Special Master at this ne.

Based upon the decision in Fidelity Assurce Association v. Sims, 318 U. S. 608, 87 L. Ed. 32, no plan was required to have been sub mitted this early date. In the Fidelity Assurance case, e court recognized that the Act did not require any finite plan to be submitted immediately, but indited instead that the debtor should be given a asonable time to formulate and submit his plan to e court, making sure that he has carefully conlered all the aspects and phases to be covered d all the conditions concerning it.

CONCLUSION

For the above reasons, which briefly ited are:

1. The Special Master's Report is incomplete for failure to contain any Finding of Fact concerning good faith;

2. The Special Master's conclusions in his report are not supported by the law;

3. The order of the District Judge is in error since his conclusions are not supported by the law or the facts and are contrary to the intent of the Act;

4. The Special Master misinterpreted the testimony concerning Finding of Fact Number 6;

5. The Special Master misinterpreted the testimony concerning Finding of Fact Number 7;

Debtor-appellant, CARSON MEADOWS, INC., respectfully prays that the order of the United States District Court for the District of Nevada be reversed, and that this cause be remanded to that court with instructions to hold another hearing on this matter and to gather full and adequate testimony concerning debtor's financial position, his proposed plan, and whether or not good faith does in fact exist.

Respectfully submitted,

Richard C. Minor

RICHARD C. MINOR
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Reno, Nevada

January 8, 1968.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 + 39 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Richard C. Minor

Richard C. Minor, Attorney